No. 14334.

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

*Appellant,*

*vs.*

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC., and WARNER BROTHERS PICTURES, INC.,

*Appellees.*

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## APPELLANT'S REPLY BRIEF.

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Appellees do not gainsay that stockholder and his corporation, citizens of different states, are on opposite sides of a justiciable controversy, viz.: whether the corporation was used unlawfully to unjustly enrich Harry Warner's family at the company's risk and expense, and to its detriment.

Nor can appellees gainsay, that all who administered the Warner Company's affiairs, to a man, viz., the so-called independent undominated directors, as well as the brothers Warner, are hostile and opposed to the objects of the suit; and that it was useless and futile for com-

plainant or any group of stockholders to demand that the corporation seek vindication or institute the suit. [R. pp. 587-588.]

> "The Court: As I understand the defendants' position, and I can be corrected if I am in error, the defendants' position is that this was an advantageous arrangement to the Warner Corporation, and the directors would have upheld it at any time against any attack by any person, including any group of stockholders.
>
> Mr. Levy: That is the position of both the individual defendants Warner brothers, and the corporation—all of them contend likewise.
>
> Mr. Williams: The individual defendants Warner brothers are not involved in that issue. It is the corporation that is involved in that issue.
>
> The Court: And, for those reasons, no matter what demand the plaintiff stockholder had made on the directors, they would never had brought this suit. Is that a fair statement of it?
>
> Mr. Williams: Yes, that is a fair statement, but not for the reasons alleged in the complaint, that there was domination; but for the reason that in the opinion of the responsible officers and directors of the corporation this was a good contract.
>
> The Court: By 'good,' you mean advantageous to the corporation?
>
> Mr. Williams: Advantageous to the Warner corporation, yes."

Nor do appellees dispute the fact that, whereas the stockholder sought a decree adjudging *unlawful* the corporation's conduct in the series of transactions in evidence, the corporation, on the other hand, sought to have the Court decree these transactions to have been *lawful* and

moreover, sought to have the Court declare that though these transactions were in fact *unlawful,* the corporation's right to relief was barred by the Statute of Limitations. And finally, nowhere in their briefs do appellees deny the realities which are exhibited by the facts, as set forth in appellant's Statement of the Case and Narrative of the Evidence. (Appellant's Op. Br. pp. 3-18.)

In sum, substance and effect, appellees admit that the Warner corporation is an adversary party in every sense of the word.

Appellees contend that nevertheless, the Warner corporation is to be aligned, not as the adversary party which it is, but as plaintiff's *ally.* They assert that such is in keeping with a "general rule" that the corporation "must be considered" as a plaintiff; that "this rule is almost a matter of definition in a derivative suit." Appellees cite *Groel v. Electric Co.,* 132 Fed. 252, as authority. (Op. Br. p. 6.)

Appellant replies that such is not and never has been the rule, general or otherwise; that neither the *Groel* case nor the cases decided in the Supreme Court, in this Court, or in any Circuit Court of Appeals, hold or suggest the existence of such a rule. To the contrary, in the *Groel* case, the rule deduced by Judge Lanning, after a "review of the authorities" (132 Fed. 263, 264) is, as quoted in appellant's brief (p. 21):

> ". . . the stockholders' corporation will be aligned with the defendants whenever the officers or persons controlling the corporation are shown to be opposed to the objects sought by the complaining stockholder, and that, when such opposition does not appear, the stockholders' corporation will be aligned with the complainant in the suit."

Appellant submits that the test provided by the rule recommends itself for its objectivity and its freedom from complexity; it is logical and realistic; its application is not productive of an incongruous situation in which a party to a litigation is perceived as a complainant when in reality the party is a defendant, in every conceivable objective aspect of the term; in the case at bar, perceiving a party as a complainant when it is not only "rooting," so to speak, for complainant's defeat, but definitely striving to bring it about; and asserting to this Court moreover, that its directorate, undominated and uncontrolled, is, to a man, antagonistic to the objects of the suit.

The rule and its rationale underlie and form the basis of an impressive, unbroken line of decisions in the Supreme Court, in this Court, and in other Circuit Courts of Appeals.

In *Central Railroad v. Mills* (1884), 113 U. S. 249, a New Jersey citizen instituted a suit in his state court. The defendants named were his corporation, a New Jersey citizen, and a Pennsylvania corporation. Complainant stockholder challenged the legality of his company's conduct in leasing its railroad property to the co-defendant, the Pennsylvania corporation, and charged that thereby his company had been defrauded. The case was removed to the Federal Court. The defendants filed a joint answer. The Federal Court remanded the case to the State Court. It held that since stockholder and his corporation were both citizens of New Jersey, the Court had no jurisdiction. The Supreme Court affirmed the lower court's order to remand, saying (p. 256):

> "All the defendants unite in defending the acts complained of, and in denying the illegality and fraud charged against them. The New Jersey corporation

> is in no sense a merely formal party to the suit, or a party in the same interest with the plaintiffs; but is rightly and necessarily made a defendant. * * * All the parties on one side of this controversy not being citizens of different states from all those upon the other side, the citizenship of the parties did not bring the case within the jurisdiction of the Circuit Court."

In *Railroad v. Grayson* (1886), 119 U. S. 240, the complaining stockholder, Grayson, an Alabama citizen, instituted a suit in his state court. The defendants named were his company, Memphis and Charleston Co., a corporation existing under the laws of Alabama, Tennessee and Mississippi, and East Tennessee, Virginia and Georgia Railroad Co., a corporation existing under the laws of Tennessee and Georgia.

Complainant stockholder challenged the legality of his corporation's conduct in arranging to pay the co-defendant $400,000 for a cancellation of a lease theretofore made by the stockholder's company to the co-defendant lessee, and authorizing an issue of $5,000,000 of additional stock to be sold at 8 cents on the dollar for the purpose of raising the $400,000. The case was removed to a Federal Court, which remanded it to the State Court on the ground that it had no jurisdiction since Grayson, complainant, and his corporation, Memphis and Charleston Co., defendant, were both citizens of Alabama. The Supreme Court affirmed. Chief Justice Waite writing for a unanimous court said:

> "We are unable to distinguish this case from that of N. J. Central Railroad v. Mills, 113 U. S. 249 . . . Under these circumstances, it is clear that the Memphis and Charleston Company is not a mere

> formal party, or a party in the same interest with Grayson, but is rightly and necessarily a defendant. The corporation, as a corporation, has determined, by a vote of its stockholders, to pay $400,000, which it proposes to raise by a ruinous sale of stock, to get rid of a lease that Grayson insists is void and ought to be annulled without any payment whatever, and the lessee brought to an account. . . . Grayson is not suing for the Memphis and Charleston Company, but for himself. It is true a decree in his favor may be for the advantage of the Memphis and Charleston Company, but he does not represent the company in its corporate capacity, and has no authority to do so. As a stockholder, he seeks protection from the illegal acts of his own company as well as the other."

The Court's attention is respectfully directed to the fact that in neither the *Mills* case, nor the *Grayson* case, *supra,* was the stockholders' corporation shown to have been dominated by the co-defendants.

In *Venner v. Gt. Northern Ry.* (1907), 209 U. S. 24, 31-32, the Supreme Court reiterated its position in the *Mills* and *Grayson* cases, *supra,* cited those cases *and cited the Groel* case *supra.* It rejected contentions that the stockholder's corporation must be aligned alongside the complainant because the suit is the corporation's although instituted by the stockholder; that the stockholder and not the corporation is the real party in interest, and said again:

> "It would doubtless be for the financial interests of the defendant railroad that the plaintiff should prevail. *But that is not enough.*

> *Both defendants unite,* as sufficiently appears by the petition and other proceedings, *in resisting* the plaintiff's claim of illegality and fraud. They are alleged to have engaged in the same illegal and fraudulent conduct, and the injury is alleged to have been accomplished by their joint action. The plaintiff's controversy is with both, and both are rightfully and necessarily made defendants, and neither can, for jurisdictional purposes, be regarded otherwise than as a defendant."

One year after the decision in the *Venner* case, *supra,* in *Delaware-Hudson Co. v. Albany and Susquehanna Railroad* (1909), 213 U. S. 435, the Court pointed out and stated clearly that the corporation's adverse position in the controversy need not be demonstrated to have proceeded from or to have been generated by sinister motives of those who administer the corporation's affairs. Speaking for a unanimous court, Justice McKenna said (p. 451):

> "The attitude of the directors need not be sinister. It may be sincere. * * * In this case, it was certainly determined. It continued until after the suit was brought."

This was similarly the holding of the Seventh Circuit Court of Appeals in *Schmidt v. Esquire* (1954), 210 F. 2d 908. The Court said (p. 912):

> "It does not seem that a different rule of alignment applies when, as in this case, there is no indication that the refusal by the corporate management to sue results from fraudulent or other improper motives."

The Court cited the *Delaware and Susquehanna* case, *supra, Ashwander v. Tennessee Valley Authority,* 297 U.

S. 288; (see Appellant's Op. Br. pp. 29-30); and *Groel v. The Electric Company, supra.*

Appellant submits that on both principle and authority the Warner corporation has been properly aligned as a defendant. (See 68 Harv. L. Rev., pp. 193-195; 38 Minn. L. Rev., pp. 877-880.)

In conclusion, appellant respectfully directs the Court's attention to a statement in appellees' brief (bot. p. 8, and top p. 9) to the effect that the Court below found as a fact, "that there was no fraud." Appellant submits that this statement is not borne out by the record.

The Court neither passed upon the merits of the controversy, nor did it make such a finding. The substance of the Court's findings, as pointed out in Appellant's Opening Brief (p. 6) is: The Warner directors "intended" the first contract (in the series of Warner-United contracts) to benefit the company; "considered" it to be a sound business arrangement and in approving and authorizing entry into this first contract, the directors acted in good faith and without fraud.

It is crystal clear that the Court did not find either the first Warner-United contract, or any of the superseding contracts, to be lawful, fair, and free from fraud. The Court made no determination thereon. It even declined to find that the first contract *was,* in fact, a sound business transaction or that it was, in fact, of benefit to the company. It inked out and deleted from appellees' *proposed* findings, a finding to this effect as well as to the effect that the *superseding contracts* (appellees termed them "amendments and supplements"), were, in fact, sound business transactions and of benefit to the company. [R. pp. 74-75.]

We submit that the learned District Court erred in concluding that it lacked jurisdiction of the First Cause of Action.

* * * * * *

* * * * * *

We submit that the dismissal of the Second Cause of Action exhibits a patent inequity: The question of the Court's jurisdiction of the First Cause of Action was raised for the *first* time at the *pre-trial* hearing. (Opin. of the Court, 117 Fed. Supp. 781 at p. 788.) This occurred in March of 1953. The action had been pending for over *four years.* It was commenced on December 15, 1948. The opinion below was filed December 16, 1953.

As narrated in Appellant's Opening Brief (p. 17) and not contradicted by appellees, Warner parted with $688,000.00—profits from two successful pictures brought out by the joint venture. This money went to United—in reality to Sperling. A substantial part thereof, viz., $625,484.26, was paid during the years 1947, 1948 and 1949. [See Extracts from Exs. 105 and 105-A, Appens. A and B to this Br. pp. 1 to 4.]

Appellees' statement (Op. Br. bot. p. 32, and top p. 33) exhibits beyond any doubt that in a California state Court to which appellant is, in effect, relegated for the protection of his rights, he will be confronted with a plea by all the defendants, that inasmuch as this money was actually paid out by Warner in 1947, 1948, and 1949, recovery thereof is barred by the Statute of Limitations. Appellees say:

> "We believe it plain, however, that the Statute of California would govern as the law of the forum; that

> the relevant section is the three-year limitation under Section 388 of the State Code of Civil Procedure since the matter is essentially one of alleged fraud; that such period of three years under this statute runs from discovery by the aggrieved party; that here the corporation is clearly the aggrieved party under the authorities herein specified."

The judgment below, which dismisses the second cause of action notwithstanding defendants' silence on the jurisdictional issue *for over four years,* tolerates a situation in which this money may be lost, irretrievably; *i. e.,* though the California State Court—to which appellant is relegated to commence a *new* action for the protection of his rights—after hearing the merits of the controversy declare these Warner-United transactions to have been unlawful; find that Harry and Jack Warner were faithless to their trust; and conclude that but for the bar of the three-year statute of limitations, they would be adjudged liable for this sum.

For the reasons urged in Appellant's Opening Brief and in this reply brief, it is submitted, that the judgment should be reversed.

Respectfully submitted,

Moss, Lyon & Dunn and
Herman H. Levy,
By Herman H. Levy,
*Attorneys for Appellant.*

## APPENDIX A.

### Extract From Exhibit 105.

In the District Court of the United States, Southern District of California, Central Division.

Edward S. Birn, Plaintiff, v. Milton Sperling, Harry M. Warner, Jack L. Warner, United States Pictures, Inc. and Warner Bros. Pictures, Inc., Defendants. Civil Action No. 9005-WM.

INTERROGATORIES

To the Defendant United States Pictures Inc.:

Pursuant to the order of the court dated April 11, 1949, authorizing plaintiff to serve and file additional interrogatories, please furnish, under oath, written answers to the following interrogatories:

1. What are the itemized costs to United States Pictures Inc. in the production of the motion picture "Cloak and Dagger" and what sums have been received each month by United States Pictures Inc., to date, from the distribution of said motion picture.

2. What are the itemized costs to United States Pictures Inc. for the production of the motion picture "Pursued" and what sums have been received each month by United States Pictures Inc., to date, from the distribution of said motion picture.

## APPENDIX B.

### Extract From Exhibit 105A.

In the District Court of the United States, Southern District of California, Central Division.

Edward S. Birn, Plaintiff, v. Milton Sperling, Harry M. Warner, Jack L. Warner, United States Pictures, Inc. and Warner Bros. Pictures, Inc., Defendants. Civil Action No. 9005-WM.

Answer to Interrogatories Submitted April 21, 1949.

To the Plaintiff Edward S. Birn:

Defendant United States Pictures, Inc. (for convenience hereinafter referred to as "U. S.") answers herewith the interrogatories presented by plaintiff under date of April 21, 1949, as follows:

Answer To Interrogatory No. 1.

The itemized costs to U. S. in the production of the motion picture, "Cloak and Dagger," are set forth on Exhibit A attached hereto.

The following are the sums actually received by U. S. to date from the distribution of said picture (the dates set forth below are the dates on which the sums were deposited by U. S. or were paid to U. S. by invoice on Warner Bros. Pictures, Inc. and concurrent credit given by Warner Bros. Pictures, Inc. against moneys owed by U. S. to Warner Bros. Pictures, Inc.):

| Date Deposited or Invoiced | Amount |
|---|---|
| 4-26-47 | 4,807.38 |
| 5-31-47 | 8,183.74 |
| 6-20-47 | 11,593,19 |
| 7-28-47 | 71,614.08 |
| 8-2-47 | 9,813.46 |
| 8-22-47 | 52,490.58 |
| 8-23-47 | 7,487.09 |
| 9-4-47 | 34,748.41 |
| 9-4-47 | 5,496.94 |
| 11-7-47 | 21,241.79 |
| 11-13-47 | 3,467.84 |
| 1-25-48 | 59,051.35 |
| 2-6-48 | 7,979.30 |
| 4-22-48 | 51,160.41 |
| 5-7-48 | 6,759.34 |
| 8-17-48 | 12,173.46 |
| 10-13-48 | 4,553.60 |
| 10-13-48 | 39,351.44 |
| 1-10-49 | 44,254.81 |
| 4-14-49 | 17,162.50 |
| | 473,390.71 |

Answer To Interrogatory No. 2.

The itemized costs to U. S. in the production of the motion picture, "Pursued," are set forth in Exhibit B attached hereto.

The following are the sums actually received by U. S. to date from the distribution of said picture (the dates set forth below are the dates on which the sums were deposited by U. S.):

| Date Deposited | Amount |
|---|---|
| 11-13-48 | 96,103.53 |
| 1-10-49 | 36,826.72 |
| 4-14-49 | 19,163.30 |